Q3 2022 On Holding AG Earnings Call - Final

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Presentation

OPERATOR: Ladies and gentlemen, thank you for standing by. Welcome, and thank you for joining the On Holding AG Q3 2022 Results Call. (Operator Instructions)

I would now like to turn the conference over to Jerrit Peter. Please go ahead.

JERRIT PETER: Good afternoon, good morning, and thank you for joining on 2022 third quarter earnings conference call and webcast.

With me today on the call are Executive Co-Chairman and Co-Founder, David Allemann; CFO and Co-CEO, Martin Hoffmann; and Co-CEO, Marc Maurer.

Before we begin, I would like to remind everyone that the remarks during today's call will contain forward-looking statements regarding future events and performance within the meaning of the federal securities laws.

These forward-looking statements reflect our current expectations and beliefs only and such statements are subject to certain risks and uncertainties that could cause actual results to differ materially. Please refer to our 20-F filed with the Securities and Exchange Commission on March 18 for a detailed discussion of such risks and uncertainties.

Please further note that this call will also contain certain non-IFRS financial measures, such as adjusted EBITDA and adjusted EBITDA margin. These measures are not intended to be considered in isolation or as a substitute for the financial information presented in accordance with IFRS. Please refer to today's release for a reconciliation of non-IFRS financial measures to the most comparable measures prepared in accordance with IFRS.

We will begin with David followed by Martin leading through today's prepared remarks, after which we are looking forward to opening the call for a Q&A session.

With that, I'm very happy to turn over the call to David.

DAVID ALLEMANN, CO-FOUNDER & EXECUTIVE CO-CHAIRMAN, ON HOLDING AG: Thank you very much, and a warm welcome from here in Zurich to everyone around the globe joining us today. I'm delighted to be here to speak about another outstanding quarter, and the exciting recent progress and developments at On.

As you will have seen in our release this morning, net sales for the third quarter increased by more than 50% to CHF 328 million, our strongest quarter in history. This makes On a CHF 1 billion net sales company. We're looking at the 12 months leading up to the end of September, and it allows us to increase our full year outlook.

During our last earnings call, we talked about how we are focusing on building a company that is set up for durable growth with the goal of being the #1 brand on runner's bodies. Today, I delve deeper into the strength of the Young brand and our most recent innovation achievements, before handing over to Martin for a detailed review of our third quarter financial performance, and details on the outlook for the rest of the year.

12 years ago, On started from out of nowhere and has built a powerful grassroots movement of millions within a few short years. It fills me with pride that we continue to inspire and attract a record amount of new runners to On. There is simply an incredible amount of momentum around On right now, and I want to focus on 3 of the key areas that are driving this growth and setting us up for sustained success.

Firstly, we are expanding the reach of the brand like never before. On has seen a record number of visitors coming to our website, with almost 10 million sessions per month recorded so far this year. Our Instagram followers just crossed the 1 million and engagement is high. We are attracting new consumers every day due to our ability to drive awareness and then meet their individual needs once we have gained their attention.

We are doing this in a number of ways, not least, via are our highly successful omnichannel approach. Our strategy connects us with consumers when and where they want to shop, either via our own physical and digital stores, wholesale partners or immersive digital platforms.

In September, we began piloting a fully redesigned website designed to deliver a richer, more immersive shopping experience. The pilot and AP testing in the U.K. has delivered great results and we cannot wait to roll it out globally in the coming months for all of our fans to enjoy.

We're also partnering with external digital platforms such as the WeChat e-commerce mini program in China. Chinese consumers can now seamlessly shop for On products without ever leaving the WeChat ecosystem.

Our increasing brand visibility is also driven by powerful marketing campaigns that resonates with our core community and reach a new breed of useful runners. Runners who are inspired by an emerging run culture that elevates running to a lifestyle. The seed of this culture was planted during the pandemic and new habits have now been formed.

These campaigns are hugely distinctive and impactful. During the Berlin Marathon, you couldn't escape our brand as we took over hundreds of key out-of-home sites across the city to support our Dream On campaign. We also partnered with the city's music festival to provide our unique take on how running inspires creativity.

And during the run -- the New York City Marathon, runners joined us at 0.2, an immersive exhibition that explore the magical mind space that can only be accessed through running.

October also saw the hotly anticipated second lower times On collection of performance footwear. It launched too much fanfare, particularly in the APAC region, where it was heavily featured in influential style media, such as Vogue Japan. Hydro choosing to build the brand is also contributing to our momentum, namely by staying true to our focus of performance innovation.

I'm thrilled to see how our newest performance product like the Cloudmonster, the Cloudrunner and the CloudGo are resonating with runners in a major way, becoming the fastest-growing product lines at our retail partners. These styles are now driving volume for us, not only in running specialty doors, but also in general sporting goods channels like big sporting goods.

Crucially, our running shoes that resonate so well with consumers are powered by the very same technology you see on the feet of our successful professional athletes and the On Athletics Club, our lead track and field team. Athletes like the Norwegian titled Gustav Iden, who won the men's Ironman World Championship in Hawaii in October.

He delivered an unbelievable performance with the new course record. But not only did Gustav set new overall course record, we played a part in Gustav running a course record marathon to finish off the race and secure the win in a On shoe specifically created to meet his needs.

Of course, this groundswell of professional athletes wanting to wear our innovative products influence its runners to choose On shoes for their daily runs and workouts. This was on full display around the New York Marathon, where our New York City store locked the strongest 2 days in history.

Our product innovations aren't just confined to footwear. The potential of our apparel business has never been greater. We're doubling down on apparels and have recently made a number of key investments to strengthen our design and development team.

In the last few months, we have also seen a great response from our community to new apparel products such as the Luma's collection of hi-vis reflective running gear and our latest sports bra line.

And just last week, we had our global meeting where our team and key partners were introduced to our next lineup of products that we will bring to market in the fall/winter '23 season. We surprised the team with 3 all new footwear silhouettes and many new and exciting apparel pieces.

As you know, brand and product desire builds lasting relationships with our consumers and turns them into eventualists. We also create long-term partnerships with retailers to ensure we do everything we can to serve and inspire consumers together.

But of course, we can't speak about lasting meaningful relationships without mentioning Roger Federer. Our partnership with Roger has never been an athlete endorsement deal. Instead, he has long been a partner, investor and co-entrepreneur of ours. He plays a truly instrumental role in the development of the Roger line and the Roger Pro tennis shoe, acting as a role model to all of his own teammates at the same time.

Like many sports fans, we have heavy hearts when Roger announced his retirement from the professional tennis game. But I'm delighted to say that he will now spend even more time with us to expand the professional On tennis business and our performance product offering as a whole.

My last and final point brings me to durable growth, not just for On, but for our planet. We are making fast progress in innovations that drive a circular future. For us, durable growth means growing responsibly. As a brand born in the Swiss Alps, nature is our home and where we run.

Our sustainability mission has always remained the same, namely, to make high-performance products with the lowest possible footprint and engineered for circularity. We focus on 3 core areas: recycle, reuse and reduce. On recent calls, we provided updates on breakthroughs we made against the first 2 ambitions, namely our cyclone subscription model. Today, I'd like to focus on the third area, carbon capture.

I'm delighted to say that Q3 was when we finally realized our dream of reducing carbon impact when we unveiled the first ever shoe made from carbon emissions with our clean cloud material. This makes on the first company in the footwear industry to use carbon emissions as a primary raw material for a shoe's midsole, a huge milestone for the sports industry and something that seemed almost impossible when we first started developing it 5 years ago.

CleanCloud will go from proof of concept to commercialization. Our ambition is to bring the technology to as many consumers as possible in the near future. Also notable sustainability achievements in the quarter included the introduction of Onward, our first-ever platform to shop and trade in preowned gear for On, customers and products stay with us longer. Onward is currently available in the U.S., and we're looking forward to see how our first foray into the resale market develops in the coming months.

To summarize, we are incredibly pleased of the progress we have made over the past 12 months and are extremely excited for the next steps we'll take on our mission to decouple On's resource consumption from our strong growth.

With that, it's my pleasure to hand over to Martin for the Q3 financial review and updated outlook for the full year. Martin, please.

MARTIN HOFFMANN, CO-CEO & CFO, ON HOLDING AG: Thank you, David, and hello, everyone, joining our call today.

Q3 has been another record quarter for On. Our net sales growth of 50.4% to CHF 328 million has been stronger than expected, and another step on our journey towards durable growth. Those of you who have followed us since the IPO know that why net sales growth is important to us, we are just as focused on expanding on profitability.

By further reducing the airfreight share and despite foreign exchange headwinds, we have achieved a record adjusted EBITDA of CHF 56.3 million, an adjusted EBITDA margin of 17.2% in the quarter. The strong results

validate a continued high demand for our brand globally. At the same time, they validate our ability to scale and professional life along all parts of the business.

David mentioned some of the factors that have driven our record sales. The success of our products, our expanding collaboration with wholesale partners, and our progress to connect even more intensely with our customers.

The high demand that we are experiencing has challenged our logistics network. While our supply chain teams across the globe have done an exceptional job to cope with the record volumes, in mid-August, we experienced temporary constraints in our U.S. East Coast warehouse caused by a system upgrade by our 3PL partner.

So our team worked fast, and the situation has been remedied. We were not able to fulfill all the demand we had in the U.S., especially in D2C, where we lost some sales due to longer delivery times and higher cancellation rates.

In addition, the strength of the U.S. dollar, in conjunction with the weakness of the euro in ratio to our reporting currency Swiss francs, had a significant negative impact on our gross profit margin, and our adjusted EBITDA margin of 250 basis points compared to the third quarter last year.

On total net sales, currency developments are mostly neutral, while regional sales are impacted. So even in spite of these headwinds, we delivered record results, which is a testament to our strong brand momentum and high-quality team-based execution.

Now let me review the strong quarterly financial performance in more detail. We, again, saw a well-balanced growth between channels, regions and product verticals. We continue to win market share at existing retail partners, while selectively expanding our distribution to reach the right customers, which helped to drive an increase of net sales and wholesale of 55.6% versus a very strong prior year period.

As announced, we started to pilot at 8 big sporting goods locations and are extremely happy how On has resonated as a head-to-toe brand with apparel and accessories, driving nearly 20% of the units sold.

On footwear, (inaudible) is certainly showing that it can drive our mission to reach every runner. Styles such as the Cloudultra, Cloudmonster and Cloudrunner have been large volume drivers during the pilot phase.

We have also increased our door count with Footlocker to 150 doors in the U.S. in connection with the fall/winter '22 season launch, which came together with very strong numbers in Q3, and excellent sell-through during the back-to-school season.

We continue to follow our strategy of seeking presence in the highest quality doors, tightly managing stock levels and, whenever possible, showcasing the trends and designated On shop-in-shop areas. A great example is our partnership with Nordstrom, where we opened 12 dedicated On shops in September.

Overall, our wholesale door count in our own markets, that means excluding distributor markets, stands at 9,050 doors as of the end of Q3 versus 8,000 doors at the beginning of the year, reflecting a strong organic growth within existing stores through both existing and new products, while expanding distribution in a very controlled way.

Moving over to direct-to-consumer, where net sales grew by 40.7% in the quarter. Without the constraints in our U.S. warehouse, we would have been able to achieve even more sales growth in D2C. Our D2C growth is well balanced and driven by the strong demand from both our existing customer groups as well as a large number of first-time purchasers that are frequently only just discovering the brand.

As David mentioned, we are also very excited about the ongoing rollout and the potential of our new online experience to further increase the engagement with our fans. We are also continuously investing in our data infrastructure to connect more directly with our customers.

Last week, I had the opportunity to visit our newest On retail store that just opened in Los Angeles, at (inaudible) Bolivar in Venice. The customer response has been incredibly strong, and we have heard many times that this is one of the nicest stores in this (inaudible) Street.

Like many of our other locations, it is not only a store, but also a launch pad for our running communities. Our next location is outside of China will be in London and Miami, for which we are looking at the openings early next year.

In China, the traffic to our On retail stores has surged back after the larger scale lockdowns in Q2 and has also significantly increased versus the prior year comparable periods. For example, our existing Beijing store saw a 40% increase in traffic in the month of August versus the prior year period.

At the same time, we opened 4 additional stores in China since early September, there are 2 in Shanghai, 1 in Beijing and 1 in Chengdu. The China retail stores also continue to be a showcase of the opportunity we have in apparel when we can actively drive our merchandising.

Our existing store in Shenzhen, as an example, even reached a 30% apparel share in Q3. Overall, considering the aforementioned dynamics in the quarter, our D2C share was 32.5% versus 34.7% in the prior year period.

Then moving on to the developments by region. Q3 net sales in North America grew 57.1% to CHF 176.3 million, driven by the strong demand for our full product line across all retail partners and direct channels. As mentioned before, we would have had even more demand from our D2C customers in the region that we were unable to fulfill due to the temporary warehouse constraints.

Net sales growth in Europe accelerated compared to Q2, and we achieved CHF 116.5 million, 31.8% year-over-year growth despite the considerable FX headwinds from a strong Swiss franc versus the euro and British pound. Demand in most key markets continues to be strong, and we are very happy to have extremely strong partners in the region as we continue our growth path.

With the expansion of JD, we saw record monthly sell-through of footwear in September, which helped the U.K. to double net sales year-over-year in Q3. And we are excited to say that Q3 also marked the successful launch with Footlocker in Europe, both in selected stores and online.

Finally, Q3 also means marathon season in Europe, and we were very present in the weeks leading up to the marathon in London and Berlin, with this year's spring campaign showcasing the power of running to ignite the human spirit.

Marc and I, of course, are amongst the big believers in this power. And so I will admit Marc did so considerably faster than I. I'm happy to share that we both crossed the finish line in Berlin with smile still on our faces, alongside many of our On teammates, friends and partners.

Net sales in Asia Pacific grew 85.2% to CHF 24.2 million, driven by the strong rebound in China following the prolonged lockdowns in Q2 as well as the continued momentum in Japan and Australia. Despite some occasional local lockdowns, China posted a year-over-year growth rate of 90% in Q3. This momentum also extends beyond Q3.

For Double 11, the biggest online shopping festival in China, On was selected as the only new sportwear brand to be featured online and offline with Tmall in the buildup to the event. Our co-branded design featuring the Cloudmonster was highly visible in major subway and bus stations across all major cities as well as digitally for the 3 weeks leading up to Double 11. This, together with our strong brand momentum led to an increase of over 135% in terms of items sold versus the prior year Double 11 period.

With a total of 7 new On retail stores opening in China in half year 2, and considerable traction on our new WeChat mini program launched in October, we expect China to be a continued growth driver for us for the years to come.

Finally, our Rest of World net sales increased 150% to CHF 11 million. As announced in previous calls, we have successfully built a network of new distributor partners across Latin America. In addition, we are also seeing a very strong demand increase in the Middle East.

Turning to our performance by product category. Net sales On shoes grew 51.6%. In August, we launched the CloudGo, which, together, with the Cloudmonster and the Cloudrunner, has completed our line of reinvented performance running products that have driven significant market share gains for us.

We expanded our collection of undyed products to the Cloud 5 and also the Cloudnova, and we are excited to showcase these blockbuster franchises in their most sustainable execution today.

As we all celebrate Roger's amazing career, we also expand the Roger Line to a new mid-top version and of course, celebrated Roger's last official tournament, with Roger Laver Cup limited edition, which caused long lines at the on stand during that event in London.

Apparel grew by 32.4% to CHF 15.2 million. Similar to last quarter, still slightly below our expectations, but we continue to build the foundation for future success by investing into our internal capabilities, our product assortment and the experience for our customers.

Gross profit reached CHF 187.4 million in the third quarter compared to CHF 131.3 million in the previous year period, representing a gross margin of 57.1% versus 60.2% in Q3 '21. As expected, we used additional airfreight to fulfill more of the high demand for some of our new products. But overall, in Q3, we further reduced the reliance on airfreight, and we are now in a more normalized position, which helped drive continued sequential improvement on gross margin versus Q1 and Q2.

Besides the planned impact of airfreight, we have experienced pressure on our margin from the lower D2C share as a result of the warehouse constraints and, even more importantly, from the negative year-over-year FX development mentioned earlier.

SG&A expenses, excluding share-based compensation and last year's one-off transaction costs related to IPO were 44.1% of net sales in Q3 this year, reduced from 46.4% in the same period last year. While we continue to invest in all parts of the business, we are also driving efficiencies and economies of scale.

Adjusted EBITDA reached CHF 56.3 million in the quarter, exceeding CHF 50 million for the first time in our history. This was up from CHF 37.9 million in the previous year, which, at that time, had been the highest quarterly EBITDA to date. The adjusted EBITDA margin of 17.2% decreased slightly from 17.4% in Q3 '21, largely due to the gross margin impact mentioned earlier, but was considerably up from the 10.8% in the last quarter.

Now moving to our balance sheet. Capital expenditures were CHF 22 million in Q3 '22 or 6.7% of net sales, largely consisting of investments into the buildouts of our offices in Zurich and Portland into new On retail stores as well as IT infrastructure.

Let me go into a bit more detail when it comes to our inventory position. Inventory increased by CHF 45.7 million or 21.1% compared to the end of June, and by CHF 118.2 million or 82% compared to the end of the third quarter last year, which, a year ago, as you remember, was unseasonably low due to COVID-induced factory shutdowns.

If we exclude in-transit inventory, which has been significantly reduced due to the reliance on airfreight between September last year and middle of this year, the inventory growth quite closely followed our net sales growth.

We are currently in a much better position to execute the demand for the upcoming holiday season than a year ago, but inventory levels were at a low point. The inventory in transit and in our warehouses has been produced to fulfill the existing orders on books, which should stay in Q4 and in early Q1.

Driven by the higher working capital and the CapEx investments, net cash at the end of Q3 reduced CHF 493 million from CHF 557.7 million at the end of the second quarter. Our strong balance sheet allows us to pursue our ambitious growth plans and upcoming investments.

Finally, towards our path of becoming a much larger company in the future, I'm very pleased to announce that we have secured the capacity with a third party to build a highly automated fulfillment center in Atlanta. This warehouse will provide additional capacity as of early next year and will replace our existing East Coast warehouse by 2025.

By then, the automation will significantly decrease our handling costs and dependency on manual labor, offering an opportunity for further SG&A leverage and continued increase of our D2C business. This contract is secured by a bank guarantee and, consequently, by dedicated cash balance.

Let's look into our future logistics setup. It's a great transition to speak about our financial outlook for the rest of the year '22 and into 2023. A very exciting and successful year is coming to the end, and we are planning to close the year on a high note.

Based on the strong performance in Q3, we are once again raising our net sales outlook for 2022 by CHF 25 million from CHF 1.1 billion to CHF 1.125 billion, which includes the confidence in our ability to drive the stronger fourth quarter than assumed in our previous guidance. This new top line reflects a strong full year growth of 55% compared to 52% in our previous guidance.

The increased outlook considers a few aspects that I would like to point out. First, the temporary constraints in our Atlanta warehouse are behind us, and we are approaching the important holiday season with a strong momentum. While we have a strong inventory position, we may see out-of-stock situations on some fast-moving styles, which we see as an important element in driving positive scarcity. Importantly, our long product life cycles allow us to remain focused on full price sales.

Given the good momentum and supply situation, we are now in a position to fully normalize the use of airfreight and do not expect an extraordinary impact in Q4. Second, we continue to see a strong demand for On products, and October was off to a very good start for the quarter. We're staying in close contact with our retail partners, and analyze our extensive customer data to carefully observe the macro and microeconomic developments.

Our order book for Q4 and for the first half of next year confirm our strong outlook, and we are [clearly] planning the business for continued strong growth. We're also focused on ensuring we stay disciplined and controlled in our cost structure to ensure we are driving durable long-term growth.

Third, we expect continued margin pressure from the combination of a strong U.S. dollar and a weak euro, both compared to our reporting currency Swiss francs. The executed price increases in the U.S. and the planned increases in Europe as of early next year offset some of the compression.

For 2022, we are increasing our adjusted EBITDA target for the full year to CHF 148 million, reconfirming our goal of an adjusted EBITDA margin of 13.2% for the year, even at the elevated top line outlook and despite the additional challenges described beforehand.

Finally, as we have previously mentioned, due to the structure of our pre-IPO equity plans, we will see the majority of the 2022 share-based compensation expenses in Q4. At the current share price level of USD 17 to USD 21, we anticipate a charge of around CHF 35 million to CHF 50 million. Each dollar higher or lower than the current share price at the time of granting in early December would then cause the share-based compensation charge to change by roughly plus/minus CHF 3.5 million.

Over the past weeks, we have spent a lot of time with our senior leadership team to shape an aligned vision for the years to come. Our order book for the first half of '23, the current demand we are seeing, and the much-improved supply environment put us in a strong position to drive continued strong and durable growth, both in Q4 and beyond.

They also allow us to approach the year cautiously to protect the position of the brand even in the current uncertain macroeconomic environment. Notably, we are committed to further increase our absolute and relative profitability with a constant focus on efficiency and improvement of adjusted EBITDA.

David listed some of the most exciting initiatives around our brands in the last month. They ultimately led to the strongest quarter in our history and an elevated outlook to close the year on a high. And we remain fully focused on accomplishing [that] in these last few months.

All of this would not be possible without our culture and the team that is standing behind it. Our new offices around the world became an incredible source of energy. We can't be thankful enough to everyone in the team for building a culture of high performance, while also focusing on everyone's wellbeing.

One of my highlights every month is to talk to our new starters and to share our history as a starting point 2-day or 3-day-long onboarding journey. Because to understand our past, it's essential to shape our future and to dream on.

With that, David, Marc and I like to open up the session to your questions. Operator, we are ready to begin the Q&A session.

Questions and Answers

OPERATOR: (Operator Instructions) The first question is coming from Jay Sole from UBS.

JAY DANIEL SOLE, EXECUTIVE DIRECTOR AND EQUITY RESEARCH ANALYST OF SOFTLINES & LUXURY, UBS INVESTMENT BANK, RESEARCH DIVISION: Great. David, you mentioned a lot of innovation that companies delivered over the last quarter, Cloudmonster, the CleanCloud. Can you just talk about the new product pipeline and the innovation that you have planned for next year? Do you see this robust as it's been over the last few quarters?

And can you talk about the kind of investments you're continuing to make in product innovation to drive the brand forward?

DAVID ALLEMANN: Very much -- very happy to talk about that because our goal is to be the #1 brand on runners' bodies over time. And so it's super important that we continue to invest in innovation. And you've seen that in the past that we regularly launch new technology platforms. Now you also see how we're working closely together with athletes. So just look at what our collaboration with Gustav Iden athlete, but also for many, many other athletes On Athletics Club to name some -- to name a group that also got an incredible followership around our core running consumer.

Now for next year, and I think we mentioned that also in the previous call, we are introducing a whole new technology platform, which is Cloud X 3, which was developed computer assisted, so that we choose the very best form factor to give you the perfect price. And so that's just the next iteration of how innovation comes out of On.

And like we mentioned here as well that the foams that we are using in shoes for our athletes and also the Speedboard is can be actually fully bio-based. You see that in the Cyclon. In Cyclon, we will be use very, very advanced foams, and advanced Speedboard, and its fully bio-based and recyclable. So you also see that we can combine high performance for athletes, but at the same time, also achieve our goal of circularity.

JAY DANIEL SOLE: Got it. And then maybe, Martin, if I can follow-up, just one other one.

Can you just talk about the impact that the warehouse constraints had on sales in terms of like a number? And then also at the same time, within Europe, how much did FX weigh on the growth rate in terms of like basis points?

MARTIN HOFFMANN: So the impact of the various constraints was mainly on direct-to-consumer because the omni sale channel traditionally has inventory so the impact there was less immediate. We would have seen a higher D2C share, if we wouldn't have seen those constraints. They really lasted for about half of the quarter. So the share of our D2C business would have been more in line with what we have seen in the past.

To the question on the FX impact on our regions, if you would look at basically the 2 key regions on a rate of last year, then the growth rate in Europe would be more around 41%, and the growth rate in the U.S. about 49%, or North America.

OPERATOR: The next question is coming from Joe Komp from Baird.

JONATHAN ROBERT KOMP, SENIOR RESEARCH ANALYST, ROBERT W. BAIRD & CO. INCORPORATED, RESEARCH DIVISION: (inaudible) Martin, if I can follow-up. Could you talk a little bit more about what's performing your top line revenue growth assumptions in the fourth quarter? And since you commented directionally on the order book into the first half of 2023, could you just maybe frame up sort of what you're seeing in terms of qualitatively the growth and the reaction from your wholesale partners, and how we should view that -- those comments in the context of sustaining good top line growth here?

MARTIN HOFFMANN: Yes. Very happy. So as we mentioned, we approached the fourth quarter with a very strong inventory position. We are out of the impacts from last year's factory closures. So we'll also be normalized on the use of airfreight.

We started the quarter very strongly. We had a good start into the holiday season. We spoke about the success during the Double 11 festival in China with 135% growth. We have a strong order book. We see continued strong demand from our retail partners as well as from our end customers. So we feel that the 41% growth that is implied in our quarter -- in our guidance for the fourth quarter confirms that.

And we also feel that we go with a similar strong momentum into the next year. We have a strong order book for the first half of the year. We are currently in the selling season to basically get the orders on book for the second half of the year, which will then also allow us to give a more precise outlook on the full year in the -- in our next call.

JONATHAN ROBERT KOMP: That makes sense. And maybe just 1 follow-up on the margin outlook. If I look at the implied fourth quarter adjusted EBITDA margin, it looks near to just slightly below the third quarter. And I want to just clarify maybe what you're embedding in that outlook given that you should have less freight, and we don't have complete history to see always the seasonality third quarter to fourth quarter, but just any comments directionally on what you're embedding in the fourth quarter margin outlook?

MARTIN HOFFMANN: That's really based on the top line that we see and the investments that we are planning to do and also the cost base that we have built. The FX impact clearly leaves the mark on gross profit, and it shows that we were able to mitigate some of the impacts. We benefit from the price increases that we have done. We benefit from the ability that we have on managing our expenses very carefully, and therefore, I think, it's a strong message that we confirm the 13.2% EBITDA margin and increase the outlook further.

And then, for next year, we see that we are able to drive some of the savings from our reduced airfreight share next year into the bottom line, but that we are also able to reinvest some of those savings into investments in the brand, especially on the marketing side.

OPERATOR: The next question is coming from Michael Binetti from Credit Suisse.

MICHAEL CHARLES BINETTI, RESEARCH ANALYST, CRéDIT SUISSE AG, RESEARCH DIVISION: Congrats on a nice quarter there with the -- despite the disruption in Atlanta.

I guess, could you tell us maybe a little bit of a continuation on the last question, besides airfreight, what are the other inputs you have visibility to today, and what guardrails we should think about that may limit upside, you said some reinvestment. What else should we think about as you think how next year you get back on track to your longer-term goals with gross margins in the high-50s, EBITDA margins over 15%?

And then I was also wondering, could you speak a little bit more to what you think is needed for the unlock in apparel growth rates to move above footwear given the small base of that business. Every time you guys opened a company-operated store, and now it seems like the [Dix] test, where you focus on head-to-toe apparel and accessories, seems to shoot up to about 20% of the mix, well above the average for the company.

I'm just wondering, what you think is the unlock you need to make that kind of mix more relevant across the entire company?

MARTIN HOFFMANN: Yes. I'm happy to start with your first part, and then maybe David elaborate further on the apparel opportunity.

So as mentioned, if we look at the excess of airfreight that we had that's about 350 basis points probably saving if we think about the normal -- more normalized year of airfreight use next year. And so that's basically the part that we intend to reinvest in a higher bottom line, but also into more contribution into market share and brand building.

We need to observe closely the currency development. So we were speaking about the impact that we have seen now in the third quarter and also in the fourth quarter based on the current environment with the weak euro and the strong U.S. dollar.

So we are in a position to approach the year with the necessary caution when it comes to building expenses and driving up our cost lines, so we are able to react to those impacts and protect both our gross profit margin as well as our bottom line.

In addition, we see that the price increases are accepted strongly from our customers. They don't lead to a slower demand. And we are also seeing that we are able to benefit from our economies of scale with our factory partners, and therefore, we do not expect an impact from inflation from higher raw material prices on our product cost.

So most of that upside from higher prices will also be available for compensating some of those FX impacts.

DAVID ALLEMANN: So, Michael, I'm very happy to take your apparel question. You mentioned it, in our On stores, apparel is up to 20% of share, in China sometimes up to 30%. And we feel that's super encouraging because it shows that we have clear product market fit with our consumers.

And so we continue that road, and we also see that when we partner with wholesale partners, where we open stores, like, for example, recently in Nordstrom, where we have shop-in-shops -- On branded shop-in-shops, we get to a similar share. So we feel product market fit is there.

Now it's about giving apparel a bigger presence in the channels where we operate and then, frankly, also expanding the portfolio in apparel because many of the pieces are actually fan favorites, which have been there for a long time and have been continued fan favorites, so that gives us stability, and that's where we can scale from.

So it's great to see that apparel is coming of age within On. And if you're talking to Chinese consumers, they don't see On as a footwear company, they see On already as a sportswear company, and that's reflected in these figures as well.

OPERATOR: The next question is coming from Jim Duffy from Stifel.

JAMES VINCENT DUFFY, MD, STIFEL, NICOLAUS & COMPANY, INCORPORATED, RESEARCH DIVISION: Congratulations on crossing the CHF 1 billion threshold on a trailing 12-month basis.

I wanted to start by asking about the wholesale business. The wholesale number is particularly strong. You've spoken about strong orders. Can you comment on channel inventories? Others are seeing cancellations, is that something you've experienced?

And I'm curious how you're seeing the brand fare against a more promotional backdrop? Has that any impact on demand as others get more promotional?

DAVID ALLEMANN: Marc, do you want to take this one?

MARC MAURER, CO-CEO, ON HOLDING AG: Yes. Welcome, everyone, also from my side. So I'm currently sitting in the APAC region. So it's quite dark out here. But it's great to be part of this call.

So we've been very close to the channel, and we actually all spent a lot of time with our biggest partners as well really exactly diving into what is inventory on hand? And how do they look at the next month? And what we're

seeing is that our inventory position in the channel is very, very healthy. It's sometimes even too low and also due to the constraints that we had in the Atlanta warehouse, and it's across the board. So it's in Europe, it's in the U.S., also in Asia Pacific and Japan, has a very, very strong sell-through, for example, with some of our key partners.

We're not seeing cancellations at all. And also the preselling meetings that we had with the largest partners now for fall/winter have been extremely positive. And I think what we always have to keep in mind is that On is right now a $1 billion brand on a 12-month basis, but there's still so much more opportunity versus some of the larger players. And I think, again, we're not in an incremental game here.

We have -- we don't -- we're not so dependent on the macro environment. We can gain so much market share still within the channel. And I think that's currently what's at play and On has a very strong momentum with all its key partners.

JAMES VINCENT DUFFY: Excellent. And on the top customer opportunity, can you speak to the evolving composition of your business between performance running, performance all day and performance outdoor product, particularly interested in momentum in the latter 2 categories?

MARC MAURER: Yes, I can probably elaborate on that, too. So we're seeing quite a balanced growth between the performance run category and the performance all day category. So both develop in line. I think what's very important for us is the metric of how is On developing at runners bodies because that's our core, that's our authenticity.

And we're very encouraged when we count on the main running routes. And when we look at the run specialty channel, where we're currently at roughly 10% share overall, but we have very, very strong preorder growth of around 70% for spring/summer '23 in that channel. So we're growing very strongly with the DP products that we've launched, with a Cloudrunner, with the CloudGo with the Cloudmonster that are tapping into a broad market. And so I think you see a very balanced growth between the 2.

And then on outdoor, which is a little bit smaller business at this point, we see that the trail category is developing very, very well. So everything that's rooted in trail also on the apparel side is performing strongly. And we see very encouraging sales through numbers on some of those products, especially the Cloudvista and with also quite a bit of opportunity in the all day market.

So we report that on basically the outdoor segment, but a lot of it will also be worn as an all day item.

OPERATOR: The next question is coming from Alex Straton from Morgan Stanley.

ALEXANDRA ANN STRATON, RESEARCH ASSOCIATE, MORGAN STANLEY, RESEARCH DIVISION: Great. Congrats on another great quarter, guys. I wanted to drill down into Europe quickly. You guys saw a great, nice reacceleration this quarter. Can you talk about what drove that change and just remind us what your biggest markets are there as well as how you think about kind of the future opportunity?

MARC MAURER: Yes. So the -- I think the biggest -- I mean, let's talk about the market first. So the biggest market is Germany. And then you see U.K., which has a very, very strong growth and becoming more and more important in Europe, also with the partnership that we have in JD. We still have quite some significant volume coming out of Switzerland and Australia, where -- it's just the markets that we have been in longest.

So it's quite balanced and -- but then we have a lot of markets that we're just tapping into it. So if you look at Italy, for example, if you look at Spain, which are both very large markets, Spain has just taken in-house Italy. We're going to take in-house from a distributor. So there's still a lot of potential there.

And when we look at the figures, I think, and Martin pointed it out, it's very important for us, the figures would have been even stronger if it wasn't for the FX impact. And we saw a bit of shift of orders on how we delivered orders between Q2 and Q3, but consumer demand was always there.

So you had a bit an impact from how wholesale would take in orders. But we were always, especially when you look at Germany and U.K., quite happy in how sell-out was developing. And I think this has now come through fully in Q3, and we're also quite happy on what we've seen in October, for example, and happening in Europe, especially given the macro environment.

ALEXANDRA ANN STRATON: Great. That's super helpful. Maybe one more quick one from me. It sounds like the Cloudmonster and some of your other recent launches have gotten some great press and acknowledgment for real technical innovation. Can you just talk to us about when exactly you launched those and maybe what you did differently with the shoe in terms of either technical components or even marketing, if there's anything different to be aware of?

DAVID ALLEMANN: I feel we are tapping right into a performance innovation where we are taking our most advanced technology, but then make it much more inclusive, like take the Cloudmonster, which gives you a lot of cushioning based on absolute premium foams, but then, of course, add a very visible technology to it, CloudTec, but almost in a (inaudible) version. So I think that gets us a lot of eyeballs and it's very intriguing to our core running community, but then, of course, also ventures beyond that core running technology.

And so it's about taking performance running technology and making it available and relevant for the masses.

OPERATOR: The next question is coming from Tom Nikic from Wedbush Securities.

TOM NIKIC, RESEARCH ANALYST, WEDBUSH SECURITIES INC., RESEARCH DIVISION: Quick clarification. Did you say that FX was a 250-basis-point impact to the gross margin in the third quarter? I thought I heard that, but I wasn't sure. And then can you tell us how much of an FX impact you're expecting for the gross margin in the fourth quarter?

DAVID ALLEMANN: Yes. So it was 250 basis points compared to last year's rates on the quarter. If we look at year-to-date, it's 170 basis points impact versus last year's rates. And we have based our guidance of the quarter on the current FX rates. And so we expect a similar strong impact for that quarter.

And then, as I said, going forward, price increases will help us to offset part of that. And of course, we closely observe where dollar and euro develop compared to the Swiss franc.

TOM NIKIC: Okay. Understood. And just on the gross margin in general, I mean, I know that there was also a headwind this quarter because of wholesale versus D2C mix, which kind of sounds like it was because of some transitory impacts. I mean, should we kind of assume over a longer time period that direct-to-consumer grows faster than wholesale as brand awareness grows and consumers go directly to your brand, and thus, over kind of a longer time period, you would expect to see a -- more of a tailwind to your gross margin from channel mix?

DAVID ALLEMANN: What we see is that On is hot in both channels. Marc elaborated on the opportunity that we have in the wholesale channels, that we are just at the starting line with our adventure with (inaudible) sporting goods, at the very beginning in Footlocker, but in many other key accounts.

Then if we look at our e-comm business, we see the strong momentum also now at the start of the holiday season, we have seen the strong momentum that we had in China. And then we continue to expand our own retail business with the store now in L.A., but then also the expansion in London and Miami earlier next year. We'll also continue to open new stores in China.

So we will drive growth in both channels, and that's important for us and important is that the customers have the best experience in both channels, that they find the product where they want to shop for the product and that we talk to the right customer in those channels, that we attract new customer groups to our products, and therefore, we are less managed the share of the different channels, but the health of the 2 channels. But we see strong momentum and growth opportunities in both of them.

OPERATOR: The next question is coming from Abbie Zvejnieks from Piper Sandler.

ABIGAIL VIRGINIA ZVEJNIEKS, RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: Great. So just broadly, I guess, how are you thinking about your consumer and how they may be more resilient in the more difficult macro, given the performance aspect of the business? And then it's great to see inventory levels back in a better position to fulfill that strong consumer demand for the brand.

So can you just talk about your -- how your lead times have evolved, and your ability to adjust your forward inventory receipts either up or down based on kind of changes in consumer demand in this uncertain environment?

DAVID ALLEMANN: Abbie, It's a great question when we -- sorry, Marc. When we founded On, Abbie, we came right out of the financial crisis. And then, as a young brand, we asked ourselves, what does that mean now in that part of the cycle? And back then, we realized that people are cutting down on some investments, but -- and they're very much still focused on something that keeps them healthy, and that is running.

And it's also one of the most accessible sports, one of the most cheap sports. The only thing that you really need is a good running shoe. That gives you a unique sensation, but also keeps you injury-free. And that's how it played out back then that we saw still people focusing on staying healthy. So we can't predict the future, but that's at least the tail from the past.

MARTIN HOFFMANN: Maybe I take the question on inventory. So we mentioned it on the call. We are in a very strong inventory position. And it's important to understand that we have flown a lot of products that were produced right after the lockdowns, and they have been -- they have reached our customers already.

So what we put on the ships later on was fresh products. So our warehouse is -- and the inventory levels there is really in line with what we expect to deliver in the next 1.5 quarters. And then it's also important to understand that, as a premium brand, we have relatively long lead time -- or product life cycle time. So it allows us to correct also some excessive positions that we have on certain products without going into this discounting.

And if you look at the growth that we have seen in inventory versus last year, then majority of -- part of that growth is coming from growth in our warehouses, but that's more 60% growth. So it's fully in line with our sales growth. And the rest is really the -- that we filled the in-transit inventory because we started to put products back into sea freight versus airfreight.

OPERATOR: The next question is coming from Aubrey Tianello from BNP.

AUBREY LELAND TIANELLO, RESEARCH ANALYST, BNP PARIBAS EXANE, RESEARCH DIVISION: Congrats on the quarter, and thanks for squeezing me in here.

First question I wanted to ask is on the Roger Federer retirement. Could you guys maybe talk a little bit about the Laver Cup event? What that did in terms of impacting the brand's visibility?

And then now that he's officially retired, how do you plan to work with Roger and, more broadly, the Tennis franchise overall where you have other athletes as well?

DAVID ALLEMANN: So, Aubrey, I mean, of course, that was an emotional moment for us when he retired. But probably the upside from that is that he will have more time. And you have to understand that he -- the Roger, for us, is a co-entrepreneur and spends a lot of time probably 20 days of the year in the lab working with us on the Roger Pro, so Pro tennis shoes, but then also on the other parts of the franchise.

And now we're just going to spend more time together because we're doubling down on the tennis business and continue to grow the franchise. So it's very important that we spend time together. And Roger is very committed to that. You probably know as well that his house is short 20-minute drive from our lab. So that comes together well.

AUBREY LELAND TIANELLO: That's great to hear. And then maybe if I could just one follow-up on China. Can you guys talk about the decision you made to own and operate your On stores there as opposed to maybe going with a partner like other brands have. What are the benefits that you see by taking -- by going this route?

MARC MAURER: I think it's -- what's very important to us is that we're able to bring a very unique and also consistent consumer experience to life. So wherever you experience On, you should do that in a premium way. And we felt for China, the best way to do it, that is on our own. So we decided to do most of our stores completely on our own.

We are partnering with local franchisees in Tier 2 cities where we feel they have better access to staff or also to certain retail locations. So you will see, and we already see franchise stores in China, but not we've launch master franchising partners.

And obviously, those has a positive margin impact than if we're able to operate the stores completely on our own. And we very much feel On is a Chinese brand with the Swiss (inaudible). So we have a completely local team, and feel we understand the market very well. We feel we have access to the best locations.

For example, we just relocated stores into ground floor level in some of the key malls, and that was very, very important to us to get even more traffic into the stores. So we feel we can all reach -- reach all of that on our own, and that's why we decided to pursue the opportunity without large multi franchising partners.

OPERATOR: There are no further questions at this time. Ladies and gentlemen, the conference is now concluded, and you may disconnect your telephone. Thank you for joining, and have a pleasant day.

Load-Date: November 18, 2022